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John A. Kitzhaber, M.D., Governor

Public Utility Commission
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August 31, 2000

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FCC MAIL ROOM

Magalie Roman-Salas
FCC Secretary
Office of the Secretary
Federal Communications Commission
445 Twelfth Street, SW, TW-A325
Washington, DC 20554

Re: DEPRECIATION RULEMAKING: In the Matters of the 1998 Biennial Regulatory Review – Review of Depreciation Requirements for Incumbent Local Exchange Carriers; CC Docket No. 98-137/Ameritech Corporation Telephone Operating Companies' Continuing Property Records Audit, et. al.; CC Docket No. 99-117; GTE Telephone Operating Companies Release of Information Obtained During Joint Audit. AAD File No. 98-26

Today, I have mailed the attached letter to Ms. Dorothy Attwood, Chief of the Common Carrier Bureau, regarding the depreciation amortization proposal in CC Docket 98-137. I am representing myself as a member of the Public Utility Commission of Oregon per ORS 756.040(3).

In accordance with Section 1.1206(a)(1)/(2) of the Commission's rules an original and one copy are being submitted to your office today, August 31, 2000. Please include it in the proceedings' public record.

Joan H Smith

Joan H. Smith
Commissioner
503-378-6611

Attachment

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List ABCDE

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August 31, 2000

Ms. Dorothy Attwood
Chief, Common Carrier Bureau
Federal Communications Commission
445 Twelfth Street, SW
Washington, DC 20554

Re: Depreciation, CC Docket 98-137

For the past several months I have observed parties in this docket try to find common ground. I am concerned about the impasse that seems to have developed regarding the depreciation waiver proposal. The impasse, as I understand it, stems from concern over what impact the FCC's decision might have on states. A number of states have filed related comments.

On the other hand, ILEC supporters have filed a number of letters pledging not to seek recovery of the amortization amount in state rates. I feel that this is an important commitment; some of the commissions doubt its efficacy.

Because there seems to be a stalemate, I am submitting this letter and its attachment to you. The attachment follows a question-and-answer format. I have attempted to pose the concerns and objections as questions because I do not wish to diminish the importance of the issues to various states. With the help of Oregon's accounting staff, I have answered the questions in order to demonstrate that adequate safeguards exist to deal with the impacts, if any, of the Commission's decision.

This project is my own as an Oregon Commissioner. I speak for no one else. I hope this letter will contribute to expediting a solution in CC Docket 98-137.

Joan H. Smith

Joan H. Smith
Commissioner
503-378-6611

Attachment

cc: Chairman Ron Eachus (OR)
Commissioner Roger Hamilton (OR)
K. Brown
J. Goldstein
S. Whitesell
K. Dixon
C. Mattey
A. Gomez
R. Beynon

An Exploration of State Concerns
CC Docket 98-137
Joan H. Smith (OR PUC) Commissioner
August 31, 2000

Q. Several large ILECs have offered a proposal for depreciation treatment in CC Docket 98-137. Why are some states concerned about the proposed "above the line" treatment of depreciation amortization?

A. These states fear that the proposal may represent a rebuttable presumption that the same treatment would be required for them, resulting in a significant intrastate rate increase. These states and NARUC also object to the proposal in part because they believe such treatment may have precedential value. However, because of the Section 152(b)(2) reservation of state authority, the FCC's action cannot create a rebuttable presumption, and the carriers have consistently agreed to not seek price increases for the intrastate portion of the depreciation treatment.

Q. Can anything force states to adopt the FCC's decision to recognize amortization above the line?

A. No. State regulators have authority to ensure their rates are just and reasonable. This reservation of state authority is found in Section 152(b)(2) of the Communications Act and was most notably upheld by the U.S. Supreme Court in Louisiana Public Service Commission v. FCC, 476 U.S. 355 (1986) (Louisiana). The federal jurisdiction cannot dictate ratemaking or depreciation treatment to the states. Nor can the carriers make the claim that federal treatment must be used.

Q. If such a local rate impact could occur, would it be substantial?

A. It cannot occur unless the state takes specific action. If a state were to take specific action, the impact would depend on whether a state has updated its depreciation rules/policies to shorten economic lives. If a state is already making gradual progress in reducing the reserve deficiencies, a cushion against rate shock will be established as the marketplace changes.

Q. Many states are not affected. Why?

A. As stated in the answer to the previous question, the states cannot be affected unless they take specific action. If the state employs the price cap methodology, it puts that state in an even better position to control the effects of its actions on depreciation.

In Oregon, under ORS 759.410 (SB 622), a company that elects our form of price cap regulation is no longer subject to earnings-based, rate base or rate of return regulation. Under this regulation scheme, a company is not subject to an earnings range. There is no low-end adjustment where rates are automatically increased nor is there a high end that triggers refunds or revenue sharing. In other words, any depreciation rate change would affect a company's earnings but would not trigger a rate change.

For other price cap plans in other states, there could be a provision for automatic flow-through of exogenous changes, i.e., separations changes, tax law changes, etc. I doubt that depreciation changes would fall into this category.

Q. Proponents insist that they would not seek price increases to recover amortization. I have mentioned 152(b)(2) and Louisiana, yet doubt remains. What accounting protections exist?

A. Under CFR 47, Part 32, there are accounts to record jurisdictional differences. These accounts recognize differences in ratemaking treatments between the federal and state jurisdictions. Typically, these include allowed rate base items differences, depreciation rate differences and operating expenses differences. These accounts are used as a deferred accounting mechanism. Unless a state decides to include these items in rate base, reserves or operating expenses or determines an amortization schedule for recovery of these items, the differences in the amounts will not trigger rate increases.

Please note that whether or not ILEC commitments are made, regulated carriers have the ability by right to seek rate increases. The burden of proof rests with the carriers. It is the state which rules on the request, and it is the state that sets its own standards and policies in these cases.

Q. What if states mirror the FCC and still use ROR regulation?

A. I understand that very few, if any, states mirror the FCC rates. Even if they do, I have not seen written arguments that assert how or why they must give the proposal the "above the line" treatment that the FCC would. To date the concerns have been vague and generally focused on the efficacy of the carriers' wording in their various letters to the FCC. No version or restatement of the ILECs' commitment not to seek intrastate price increases has sufficed.

Whatever the wording or assertions, if states are under ROR regulation, I contend that the Part 32 jurisdictional accounts can be used to insulate those states until they decide the treatment, if any, of these items.

Q. Is the ILECs' proposal to bring their regulatory books in line with their financial books good public policy?

A. Yes, in a competitive market their books should and will have to be kept on the same basis as their competitors. The financial markets will require it as the incumbents leave traditional regulation behind.

As regulators we must prepare for that eventuality by making all the necessary decisions to preclude or mitigate rate shock.